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14. ABSTRACT Since the decision by the Communist Party of Vietnam to transform its state-controlled economy into a more market driven one nearly three decades ago, the country has enjoyed tremendous growth and shown favorable gains in key economic indicators. The success of Vietnam's transition to a market economy has not been without challenges. Its economy has been significantly affected by external financial crises and macroeconomic instability, the result of which has been double digit inflation and reduced foreign investment. This has led analysts to question the ability of Vietnam to continue its economic growth over the long term. In view of the recent economic turbulence, this paper contends Vietnam must pursue economic, financial and socio-economic strategies to develop private domestic enterprises, in addition to, attracting foreign direct investment to encourage long term growth. An economic strategy is needed to reduce the impact of inefficient state owned enterprises on the Vietnamese economy. The financial strategy must ensure access to bank loaned capital for private domestic enterprises. The socio-economic strategy must develop a labor pool that possesses the requisite high technology skills. This paper concludes that successful implantation of these strategies will greatly aid stable growth of the economy and will help Vietnam continue to reach its modernization goals.					
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Strategies for Long Term Economic Growth in Vietnam

by

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A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.

The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.

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01 November 2013

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ABSTRACT

Strategies for Long Term Economic Growth in Vietnam

Since the decision by the Communist Party of Vietnam to transform its state-controlled economy into a more market driven one nearly three decades ago, the country has enjoyed tremendous growth and shown favorable gains in key economic indicators. The success of Vietnam's transition to a market economy has not been without challenges. Its economy has been significantly affected by external financial crises and macroeconomic instability, the result of which has been double digit inflation and reduced foreign investment. This has led analysts to question the ability of Vietnam to continue its economic growth over the long term. In view of the recent economic turbulence, this paper contends Vietnam must pursue economic, financial and socio-economic strategies to develop private domestic enterprises, in addition to, attracting foreign direct investment to encourage long term growth. An economic strategy is needed to reduce the impact of inefficient state owned enterprises on the Vietnamese economy. The financial strategy must ensure access to bank loaned capital for private domestic enterprises. The socio-economic strategy must develop a labor pool that possesses the requisite high technology skills. This paper concludes that successful implantation of these strategies will greatly aid stable growth of the economy and will help Vietnam continue to reach its modernization goals.

INTRODUCTION

Since the decision by the Communist Party of Vietnam to transform its state-controlled economy into a more market driven one nearly three decades ago, the country has enjoyed tremendous growth and shown favorable gains in key economic indicators such as Gross Domestic Product (GDP) and average monthly income per capita. Additionally, Vietnam's entry into bilateral and multi-lateral trade agreements further attracted foreign investors seeking to tap into a widely undeveloped Vietnamese market. So strong was the economic performance that in 2008, the United Nations Development Program lauded Vietnam as having "the most successful transition economy of the past decade."¹

The success of Vietnam's transition to a market economy has not been without challenges. Its economy has been significantly affected by external financial crises and macroeconomic instability, the result of which has been double digit inflation and reduced foreign capital due to loss of investor confidence.² This has led analysts to question the ability of Vietnam to continue its economic growth over the long term. Despite these challenges, Vietnam continues to show increases in real GDP, and the government set a goal for the country to become a modern industrialized economy by 2020.³ In order to achieve this goal, the government must address several underlying issues within the economy and the country as a whole. While an exhaustive list of issues to address is beyond the scope of this paper, the government of Vietnam is developing strategies to address many of the concerns.⁴

¹ IHS Global Insight, "Country Report Vietnam," *EBSCO Host*, April 4, 2013, Accessed September 6, 2013, <http://search.ebscohost.com/login.aspx?direct=true&db=bth&AN=86710391&-site=eds-live>, 17.

² Deepak Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, Joint Donor Report to the Vietnam Consultative Group Meeting, World Bank, 2011, 11.

³ Government of Vietnam, "Socio-Economic Development Plan for the 2011-2015 Period," *Social Republic of Vietnam Government Portal*, November 8, 2011, Accessed October 4, 2013, <http://www.chinhphu.vn/portal/page/portal/English/strategies/strategiesdetails?categoryId=30&articleId=10052505>.

⁴ Government of Vietnam, "Master Plan on Economic Restructuring in Association with Conversion of the Growth Model Towards Improving Quality, Efficiency and Competitiveness During the 2013-2020 Period,"

In view of the recent economic turbulence, Vietnam must pursue economic, financial and socio-economic strategies to develop private domestic enterprises, in addition to, attracting foreign direct investment, to encourage long term growth.

BACKGROUND

To appreciate the current status of Vietnam's economy, it is useful to understand the history of its transition. In 1986, the Communist Party of Vietnam (CPV) undertook a series of economic reforms during a period known as *doi moi* (renovation).⁵ The goal of these reforms was to transition the economy from a centrally planned one to a market driven one under a socialist one party government.⁶ In its commitment to economic liberalization, the CPV entered into several international trade agreements to include the Association of South East Asian Nations (ASEAN) in 1995, as well as the World Trade Organization in 2007. Vietnam also entered into bilateral trade agreements with the United States and Japan in 2000 and 2008, respectively. These agreements led to increased access to export markets, a significant increase in foreign direct investment, and lower prices on goods and services.⁷ Additionally, the commitments to these trade agreements required Vietnam to demonstrate greater transparency in laws, regulations and administrative procedures as well as the means to enforce them.⁸ As such, Vietnam undertook internal reforms by making changes to laws deemed necessary to continue economic development. The First New Enterprises Law, passed in 2001, streamlined the bureaucratic processes associated with obtaining numerous business licenses required for private domestic enterprises. As a result, the number of

Socialist Republic of Vietnam Government Portal, February 19, 2013, Accessed October 4, 2013, <http://www.chinhphu.vn/portal/page/portal/English/strategies/strategiesdetails?categoryId=30&articleId=10-052090>.

⁵ Suiwah Leung, *Economy (Vietnam)*, Country Report, (London: Routledge, 2013), 17,1.

⁶ Vo Tri Thanh and Nguyen Anh Duong, "Revisiting Exports and Foreign Direct Investment," *Asian Economic Policy Review*, 2011: 112-131,112.

⁷ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 15.

⁸ Ibid.

registered businesses grew rapidly. The Second New Enterprises Law passed in 2006 sought to ensure equal status for domestic and international investors, as well as, state owned enterprises (SOEs) and private enterprises.⁹ These actions by the CPV demonstrated political stability in Vietnam and further increased foreign investment.¹⁰ Vietnam appeared well on its way in transitioning to a fully open market economy.

The transition to a market economy brought many benefits to Vietnam. To appreciate the impact the transition to a market economy has had, it is worthwhile to look at the performance of key economic and socio-economic indicators. The most prominent indicator of the health of an economy is gross domestic product. Gross domestic product (GDP) is defined as the total value of all goods and services produced by a country's economy.¹¹ GDP expressed as a percentage indicates the amount an economy grew over the previous year. This is known as GDP growth or economic growth.¹² Real GDP growth is a measure of how much the economy grew after adjusting for inflation. Impressively, Vietnam has sustained positive real GDP growth every year since the beginning of doi moi.¹³ Throughout the 1990s, Vietnam maintained an average annual growth rate between 7 and 8 percent.¹⁴ During the same period, the United States, fueled by the unprecedented economic success of the internet boom, only achieved a peak economic growth of 4.9 percent.¹⁵ Of course, comparing Vietnam's economy to that of the United States does not give an indicator of overall economic strength; it does, however, provide some perspective on the explosive

⁹ Leung, *Economy (Vietnam)*, 2.

¹⁰ Ibid.

¹¹ Charles Wheelan, *Naked Economics: Undressing the Dismal Science*, (New York: W.W. Norton & Company, 2010) , 193.

¹² Ibid.

¹³ IHS Global Insight , "Country Report Vietnam," 6.

¹⁴ Leung, *Economy (Vietnam)*, 1.

¹⁵ The World Bank, *Data: Economic Policy and External Debt*, 2013, Accessed October 19, 2013, <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD/countries>.

economic growth Vietnam experienced in a short period of time. Another indicator of the success of the transition of the Vietnamese economy was the strong influx of foreign direct investment (FDI). In developing countries, FDI is viewed as a growth enhancing factor by providing capital to domestic enterprises and increasing the labor force through job creation.¹⁶ From the period of 1990 – 1997, FDI increased at an impressive average rate of 43 percent annually.¹⁷ In 2008, FDI peaked at an all time high of 9.6 billion U.S. dollars (USD).¹⁸ However, unlike the consistent increases in GDP, FDI had periods of decreases based many factors, both internal and external to the economy. Two of the biggest decreases occurred during the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis.¹⁹ Following the crises, FDI inflows were sluggish to return to previous levels due to a lack of investor confidence. Vietnam has yet to achieve pre-crisis levels of FDI following the decrease in 2008, which has caused economic concern for the country.

The benefits Vietnam has enjoyed since the beginning of doi moi have not been confined to the economy. Arguably, the most significant benefit of the transition has been the socio-economic improvements for the Vietnamese people, particularly in their standard of living. According to the Vietnamese General Statistics Office, in 1995 the average monthly income per capita was 295,000 Vietnamese Dong (VND), or approximately 14.16 USD, using constant 2013 dollars. By 2012, this figure had risen to 2,000,000 VND or 96.06 USD.²⁰ Additionally, the percentage of the population living below the poverty level in 1998

¹⁶ Thu Thi Hoang, Paitoon Wiboonchutikula, and Bangorn Tubtimtong, Bangorn, "Does Foreign Direct Investment Promote Economic Growth in Vietnam?" *ASEAN Economic Bulletin* 27, no. 3 (2010): 295-311.295.

¹⁷ Leung, *Economy (Vietnam)*, 1

¹⁸ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, Country Report, (East Syracuse, NY: The PRS Group, 2012), 6.

¹⁹ Business Monitor International, *Vietnam Business Forecast Report: Recovery Losing Momentum*, Business Forecast, (London: Business Monitor International Limited, 2013), 17.

²⁰ General Statistics Office of Vietnam, *GSO Education, Health, Culture and Living Standard*, September 2013, Accessed October 18, 2013, http://www.gso.gov.vn/default_en.aspx?

was calculated at 37 percent. This had been reduced to 11 percent by 2012.²¹ The labor market has shown a tremendous response, as well. According to the Asian Development Bank, the population of Vietnam grew 18.6 percent from 1998 – 2012. During the same period, the total employed labor force grew by 46 percent, nearly 28 percent over population growth.²² Despite economic and socio-economic successes, Vietnam's recent economic challenges raise questions about its ability to sustain such impressive growth.

RECENT ECONOMIC CHALLENGES

Since doi moi, Vietnam has encountered periodic economic challenges. The most recent occurred in 2008 just prior to the onset of the Global Financial Crisis. During this period, inflation peaked at 23 percent.²³ There are several factors that contributed to this. One was a supply shortage of rice, which is Vietnam's number one agricultural export. The corresponding shortage led to a spike in the commodity price helping to cause inflation.²⁴ Another reason was the massive increase of FDI capital injected into the economy. The readily available capital combined with bad lending practices by banks for speculative investing caused the economy to "overheat" and consumer prices across the country to increase.²⁵ After 2008, inflation had returned to single digits before again rising to 18.7 percent in 2011, again due to high global food prices.²⁶ By 2012, inflation had subsided to around 9 percent, but analysts expect it to remain prone to fluctuations over the next few

tabid=474&idmid=3&ItemID=13993. Note: US Dollars calculated using 20820 VN Dong: 1 USD exchange rate listed on GSO website.

²¹ Ibid.

²² Asian Development Bank, *Key Indicators for Asia and the Pacific 2013: Vietnam*, July 01, 2013, Accessed October 18, 2013, <http://www.adb.org/publications/key-indicators-asia-and-pacific2013?ref=publications/-series/key-indicators-for-asia-and-the-pacific>.

²³ The World Bank, *Data: Inflation, Consumer Prices*, 2013, Accessed October, 18, 2013, <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG/countries>.

²⁴ IHS Global Insight, "Country Report Vietnam," 8.

²⁵ Leung, *Economy (Vietnam)*, 11.

²⁶ IHS Global Insight, "Country Report Vietnam," 8.

years due to trade deficits, reliance on imports for manufacturing materials and a weak monetary policy.²⁷ In an effort to control inflation, while keeping the economy growing in a global economic downturn, Vietnam undertook a number of monetary measures. Among these measures were credit tightening policies on consumer lending in order to reduce inflation. While this brought inflation somewhat under control, credit available to businesses and investors was greatly reduced.²⁸ As Vietnam worked to regain macroeconomic stability, it was during this period that several cases of financial mismanagement in both State Owned Enterprises and State Owned Commercial Banks were exposed. Today Vietnam continues to work towards stabilizing its economy, but the net result of the macroeconomic turbulence was a slowdown in GDP growth and a reduced confidence in the country's economic management policies.²⁹ It is clear Vietnam must make fundamental changes to continue long term economic growth.

ECONOMIC STRATEGY

To develop private domestic enterprises and attract outside investment necessary for sustained growth, Vietnam must pursue a strategy which implements reforms to its current economic structure. The economic structure of Vietnam consists of three main categories of business enterprises: State Owned Enterprises (SOEs), Non-State Enterprises (NSEs) and Foreign Investment Enterprises (FIEs).³⁰ The SOEs consist of entities in which the state contributed greater than 50 percent of an enterprise's total registered capital. In 2011, Vietnam's General Statistics Office (GSO) listed the number of SOEs at 3265. According to the GSO, NSEs are comprised of private enterprises, collective name companies, limited

²⁷ Ibid.

²⁸ Leung, *Economy (Vietnam)*, 8.

²⁹ Ibid, 12.

³⁰ Socialist Republic of Vietnam General Statistics Office, *Statistical Yearbook of Vietnam 2012*, Official Government Report, (Hanoi: Statistical Publishing House, 2013), 201.

liability companies, private joint-stock companies, and joint-stock companies in which the state contributes less than 50 percent of the total registered charter capital. The GSO listed the number of NSEs at 312,416 at the end of 2011. The number of FIEs at the end of 2011 was listed at 9010 and consists of 100 percent registered capital contributed by foreign entities as well as joint ventures with either SOEs or NSEs.³¹ While the overall number of SOEs is small compared to NSEs and FIEs, further analysis reveals a significant negative impact by the SOEs on the economy. Vietnam must, therefore, pursue an economic strategy which lessens the negative impact of SOEs by increasing their efficiency, increasing managerial and financial transparency and accelerating privatization. These steps are necessary to continue to attract FDI as well as encourage development of private enterprises.

Despite their relatively small number, SOEs are inefficient consumers of resources, particularly capital and labor. Although in 2011 SOEs made up only 1 percent of the total number of enterprises in Vietnam, they drew 15.3 percent of the labor resources, consumed 34 percent of the average annual capital contribution and maintained 43 percent of the value of fixed-assets and long term investments. In comparison, NSEs made up 96 percent of the total enterprises in Vietnam, but drew 61 percent of the labor resources, 50 percent of the average annual capital and maintained only 39 percent of the value of fixed-assets and long term investment.³² Clearly, SOEs use a disproportionate percentage of resources compared to their small number. These resource amounts are not all together surprising as SOEs tend to operate in industries such as energy, telecommunications and petrochemicals that are labor intensive and generally expected to consume greater capital and fixed assets.³³ However, further analysis using methodology offered in the World Bank *Vietnam Development Report*

³¹ Ibid.

³² Ibid, 201-237.

³³ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 27, 31.

2012: *Market Economy for a Middle-Income Vietnam* and using data from the official GSO sources demonstrated the SOEs are inefficiently using capital in terms of product output.³⁴

Product output efficiency can be expressed as the ratio of total capital resources consumed to total net turnover. Net turnover is defined by the GSO as the “total income an enterprise gained by selling its products, goods or services...”³⁵ By examining how much capital in VND it takes to produce one VND of net turnover, it is possible to see how efficiently the enterprise operates with its capital assets. The lower the ratio number means the enterprise used less capital to produce one VND of output. Conversely, the higher the number, the more capital it takes to produce one VND of output. By examining the 2011 data from the GSO, SOEs had a capital to net turnover ratio of 1.73, meaning it took 1.73 VND to produce a single VND of output. The NSEs had a lower ratio of 1.33 indicating that, across the board, they used capital more efficiently than SOEs. Coincidentally, the FIEs had a ratio of 1.15 for 2011 indicating they are operating most efficiently.³⁶ Clearly SOEs are much more resource inefficient than private domestic and foreign enterprises.

Through the preceding analysis, it is apparent that, though small in number, SOEs are consuming a disproportionately greater amount of resources, namely labor, capital and fixed assets; and are using these resources less efficiently. Vietnam’s economic strategy must find ways to ensure these resources are being used as efficiently as possible. It, therefore, seems sensible that an economic strategy should consider diverting capital resources to more efficient NSEs in order to increase net turnover and thereby increase the rate of economic

³⁴ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 31-33 and Ministry of Planning and Investment General Statistics Office, *Development of Vietnam Enterprises in the Period of 2006-2011*, Official Government Report, (Hanoi: Statistical Publishing House, 2013), 110-115.

³⁵ Ministry of Planning and Investment General Statistics Office, *Development of Vietnam Enterprises in the Period of 2006-2011*, 405.

³⁶ Ibid, 99-103, 415.

growth. Furthermore, foreign entities looking to invest in Vietnam would likely be inclined to contribute capital to the private sector rather than the state-owned sector.

Unfortunately, inefficiency is not the only concern with SOEs. Ineffective oversight and a lack of corporate transparency are also issues. At one time, SOEs had been considered an attractive option for banks to lend capital as there was a general understanding the loans would be guaranteed by the government.³⁷ However, a 2010 debt default by a giant SOE conglomerate changed that perception. Vinashin shipbuilding was a huge firm which operated 39 ship yards, employed 70,000 workers and accounted for nearly 80 percent of the shipbuilding capacity across Vietnam. From 2006 to 2010, the company overextended itself by signing shipbuilding contracts that were either not completed or cancelled due to the global financial crisis. Additionally, the company speculatively developed over 200 subsidiary enterprises outside its core industry, generating even greater debt. When the company defaulted on 600 million USD to international lenders, an investigation revealed the company had amassed over 4.4 billion USD worth of debt, which was more than 300 percent of its annual revenues and 10 times the amount of equity it possessed.³⁸ The fallout from the default was devastating for the CPV. The government refused to bail out the company which led to a decrease in Vietnam's credit rating among all three international rating services.³⁹ The decreased credit rating made it significantly more costly for Vietnamese firms to borrow funds, particularly from international lenders.⁴⁰ Additionally, the government was forced to adopt new policies requiring the same level of transparency and public disclosure for SOEs

³⁷ Leung, *Economy (Vietnam)*, 9.

³⁸ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 38.

³⁹ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, 19.

⁴⁰ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 54.

as NSEs.⁴¹ The government also enacted a mandate for SOEs to divest businesses from non-core industries, further weakening the troubled economy.⁴² In the larger view, the Vinashin default had spillover effects to the private sector. As has been mentioned, the cost for all Vietnamese firms to obtain international lending became too costly. Additionally, as lenders and potential investors could no longer be guaranteed the government would back SOEs, FDI diminished across all sectors from a lack of investor confidence. The government must ensure effective enforcement of oversight and transparency reforms to rebuild the confidence needed to restore FDI inflows to previous levels necessary for long term economic growth.

Lastly to develop private domestic enterprises, Vietnam's economic strategy must address acceleration of "equitization" (privatization) of SOEs. In 1989, Vietnam had over 12,000 SOEs. From 1989 until 2005, the state reduced that number to just over 4,000 through equitization, divestment, mergers and closure of small or non-performing SOEs.^{43,44} From 2005 until 2011, the pace reduction of SOEs slowed, with only 821 reductions or equitizations of SOEs in the six year period, 94 percent of which occurred prior to 2008.⁴⁵ The slowdown after 2008 may have been partially related to the Global Financial Crisis during which time the CPV focused resolving on macroeconomic instability within the economy. Despite the slowdown in the equitization process, Vietnam still appears committed to continuing the equitization process. In its 2013 *Master Plan on Economic Restructuring*, the government of Vietnam recently reaffirmed its commitment to divest SOEs by "speeding up equitization and diversifying owners of the enterprises in which the State full ownership is [deemed] unnecessary." The plan also included "accelerating, on

⁴¹ Ibid, 45.

⁴² Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, 11.

⁴³ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 26.

⁴⁴ Socialist Republic of Vietnam General Statistics Office, *Statistical Yearbook of Vietnam 2012*, 201.

⁴⁵ Ibid.

market principle, the divestment of State capital from minor lines of business, from industries unrelated to main lines of business, and from joint-stock companies in which the State dominant share is unnecessary.”⁴⁶ While it appears that the CPV intends to reduce its stake in SOEs, there is concern that there are more institutional reasons for the slow equitization. One suspected reason is that the process has been delayed by bureaucratic inefficiency as well as opposition from state managers and local officials.⁴⁷ Another reason for the delay may be due to political tensions that are perceived to exist with liberalizing state owned assets. The perception is that any economic disruption from further equitization may constitute a destabilizing threat to the CPV.⁴⁸ Additionally, the CPV may delay further equitization by first reforming existing SOEs, particularly large ones, as exposure of another Vinashin incident could cause considerable damage to Vietnam’s international economic standing.⁴⁹ An economic strategy adopted by Vietnam, however, should not further delay the equitization of SOEs. The benefits of liberalizing the private sector, including equitization have been well documented. Studies in 2002 and 2005 highlighted the positive indicators of equitization through increased turnover, profit, value added and labor income.⁵⁰ Additionally, Vietnam’s enactment of the Second New Enterprises Law in 2006, which sought to ensure private enterprises receive equal treatment to SOEs, resulted in significant increases in FDI and reached an all-time peak in 2008 due to the prospect of less government restrictions, low cost labor and reductions in the cost of business.⁵¹ Unfortunately, with the recent macroeconomic instability and continued delays of SOE equitization, FDI has not

⁴⁶ Government of Vietnam, "Master Plan on Economic Restructuring in Association with Conversion of the Growth Model Towards Improving Quality, Efficiency and Competitiveness During the 2013-2020 Period.

⁴⁷ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, 19.

⁴⁸ Ibid.

⁴⁹ Ibid, 4.

⁵⁰ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 39.

⁵¹ Leung, *Economy (Vietnam)*, 4.

regained 2008 levels. In view of the steps the government has taken to correct macroeconomic instability, it is imperative the CPV also adopt an economic strategy focused on reforming and equitizing SOEs. These economic reforms will not only further reinvigorate FDI, but also further develop the more efficient and transparent private enterprise sector, which will positively contribute to long term economic growth.⁵²

FINANCIAL STRATEGY

Both state-owned and non-state enterprises must have access to capital to finance current operations while investing for future expansion. Capital can come from several means such as sale of stocks and bonds or through credit from banking institutions. Sale of stocks and bonds is market driven and reliant upon customer demand to raise capital. This method poses risk and may not raise the required capital in a sufficient or timely manner. The enterprises then would be forced to rely upon accessible credit from banking institutions to meet capital demands. If banking institutions fail to provide accessible capital, then enterprises become challenged to continue and/or expand operations. In Vietnam, the banking system as a whole has struggled to meet domestic credit needs, particularly since the start of economic turmoil in 2008. Vietnam must therefore pursue financial strategies which restore accessibility to capital required for stable, long term economic growth.

To restore reliable access to capital, Vietnam must address two key banking issues: the preference towards SOEs and an ineffective regulatory policy contributing to bad loans. State owned commercial banks (SOCBs) prefer lending to SOEs, and there are several reasons for their preference.⁵³ First, the assets loaned by SOCBs are considered to be state owned, the loss of which is considered an offense that could receive capital punishment. As

⁵² Business Monitor International, *Vietnam Business Forecast Report: Recovery Losing Momentum*, 22.

⁵³ Leung, *Economy (Vietnam)*, 8

such, SOCB loan officers prefer to conduct business with SOEs since assets are being shifted to another state entity rather than risk a loan to private enterprises.⁵⁴ Secondly, SOEs have access to urban land which can be used as collateral for the loans. The NSEs have historically had challenges obtaining urban land rights to use as collateral for loans again making it difficult to obtain needed credit.⁵⁵ Lastly, SOCBs are prohibited by law from providing loans to businesses less than two years old. This makes it difficult for start-up enterprises to obtain credit needed to begin operations.⁵⁶ This bias towards SOEs leaves few domestic options available to NSEs trying to obtain credit as state financial interests dominate Vietnam's banking system. As of 2011, Vietnam had five State Owned Commercial Banks (SOCBs). Yet, despite their small number, SOCBs make up over 50 percent of the banking market in terms of deposits and loans.⁵⁷ There were also 35 Joint Stock Banks (JSBs) in Vietnam as of 2011.⁵⁸ The government provided charter capital to at least 22 of the JSBs, 19 of which received their charter capital directly from SOEs.⁵⁹ Given the extent to which the government and the SOEs have financial interests in a majority of JSBs, it is certainly reasonable to assume institutional preference towards SOEs transcends to the JSBs, as well. Evidently, Vietnam is aware of this institutional preference. In its *Master Plan on Economic Restructuring*, the Vietnamese government directed the State Bank of Vietnam to guarantee "fair, equal and transparent access [to credit] for all investors and enterprises in all economic sectors."⁶⁰ As part of a financial strategy, the CPV must follow

⁵⁴ Ibid.

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Ibid, 9.

⁵⁸ Ibid, 8.

⁵⁹ Mishra, *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam*, 29.

⁶⁰ Government of Vietnam. "Master Plan on Economic Restructuring in Association with Conversion of the Growth Model Towards Improving Quality, Efficiency and Competitiveness During the 2013-2020 Period."

through on this commitment for equal access to credit to ensure private enterprise can expand operations and ultimately contribute to Vietnam's long term economic growth.

Vietnam must also work towards making capital more accessible by ensuring a sufficient quantity of funds is available for use by investors. Since assets are limited, the banks must employ discretion in their loans to ensure the assets will be invested in a responsible manner. This did not happen in Vietnam. Operating within a relatively "lax regulatory environment" many SOEs ineffectively used bank loaned funds as a quick means to generate profit through speculative investments particularly in real estate markets.⁶¹ This resulted in a rush for capital and led to a shortage of domestically available funds causing many SOEs to arrange loans from private institutions overseas.⁶² The burst of the speculative markets, combined with reduced FDI inflows and the slowed growth of the economy, led to widespread default on domestic and international loans by many SOEs, such as Vinashin. In 2012, estimates by the Government of Vietnam placed the number of non-performing loans at up to 10 percent of all loans, although some analysts believe the actual number of non-performing loans may be double that amount.⁶³ Moody's Investor Services conducted an analysis and subsequently downgraded Vietnam's credit rating due to the extent of non-performing loans.⁶⁴ The credit tightening policy that followed led to more than 100,000 small local businesses being forced to close in 2011 and 2012.⁶⁵ As a result, Vietnam plans to establish a credit debt management agency to address the significant

⁶¹ Leung, *Economy (Vietnam)*, 9.

⁶² Ibid.

⁶³ Simon, Roughneen, "Vietnam's "Tiger" Economy Losing Its Roar," *The Christian Science Monitor* (The Christian Science Monitor), November 2012: 4.

⁶⁴ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, U-2, 4.

⁶⁵ Europa World Online, *Economic Affairs (Viet Nam)*, 2013, Accessed August 30, 2013, <http://www.europaworld.com/entry/vn.is.67>.

number of non-performing loans, which should help restore confidence over the long-term.⁶⁶ Additionally, Vietnam has recently lowered interest rates on refinancing intended to increase demand for banking loans.⁶⁷ However, it is unclear what the government intends to do to address the availability of credit across the banking sector. Without a financial strategy that reduces the policy of credit tightening, private enterprises will continue to be affected by lack of access to capital for investment and thereby extending the slowdown of the economy.⁶⁸

SOCIO-ECONOMIC STRATEGY

Vietnam has historically been attractive to FDI due to its highly literate population and low cost of labor. Foreign investment has significantly increased Vietnamese total exports and was a key reason for the high levels of economic growth. To continue long term economic growth, however, Vietnam must pursue a socio-economic strategy designed to increase the capacity and skill of its labor pool, particularly within the private domestic sector.

The rapid growth of Vietnam's economy, generated in large part by strong inflows of FDI, contributed to an increase in exports some 2500 percent from 1991-2008.⁶⁹ The biggest exports were crude oil, agricultural and fish-products, textiles and footwear and according to the GSO, these were still the leading export categories in 2011.⁷⁰ Additionally, companies like Samsung and Nokia have invested heavily into the rapidly rising export market for computers and electronics, though the Vietnamese contribution to the value chain in these

⁶⁶ Business Monitor International, *Vietnam Business Forecast Report: Recovery Losing Momentum*, 23.

⁶⁷ Ibid, 5.

⁶⁸ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report*, 13.

⁶⁹ IHS Global Insight, "Country Report Vietnam," 17.

⁷⁰ General Statistics Office of Vietnam, *Trade, Price and Tourism: Some Main Goods for Exportation*, September 2013, Accessed October 18, 2013, http://www.gso.gov.vn/default_en.aspx?tabid=472&idmid=-3&ItemID=13213.

products has mainly been the assembly, not manufacture, of components.⁷¹ The commonality in these export categories is that they are labor intensive, generally requiring low skilled workers. These industries have been at the top of the export market because they took advantage of Vietnam's abundant supply of educated, low-cost workers in jobs requiring relatively low skill levels.

Certainly since the beginning of doi moi, the growth of Vietnam's export industries contributed significantly to increasing the standard of living of its labor force. It allowed Vietnam to achieve the status of a Middle Income economy in 2008. However, the reliance on low cost and generally unskilled labor force to attract FDI and boost exports has led Vietnam to enter what has been referred to as the "Middle Income Trap."⁷² This means Vietnam's economy has grown to the point where the majority of its people have achieved middle income status; however, the general lack of skills within the labor pool needed to attract and/or develop high-technology, high-yield industries will leave the country falling short of achieving high income status.⁷³ This will be a challenge to Vietnam achieving the status of a modern industrialized nation by 2020.

Vietnam's stagnation in the Middle Income Trap creates another challenge for the country's long term economic growth. As has been pointed out, Vietnam's success relies substantially on its low cost labor pool in key export industries. Vietnam's competitiveness in international export markets, as well as attractiveness to FDI, is contingent upon savings generated from a low cost labor pool. However, the cost of labor is on the rise, particularly skilled labor. Before 2012, minimum labor wages for foreign invested companies had been higher than that of minimum wages for domestic companies. This made foreign companies

⁷¹ Leung, *Economy (Vietnam)*, 13.

⁷² Roughneen, "Vietnam's "Tiger" Economy Losing Its Roar."

⁷³ Leung, *Economy (Vietnam)*, 13.

attractive to Vietnamese workers. By the end of 2012, domestic and foreign owned companies were required by law to adhere to the same minimum wage.⁷⁴ This not only affects the domestic companies by raising labor costs, but it also affects foreign companies, who now must compete with domestic firms for workers; as working for domestic firms has become more popular since the pay gap has been reduced.⁷⁵ As competition for labor increases, further wage increases can be expected.⁷⁶ The increased labor costs will increase competition with other developing countries in the region also seeking to attract foreign companies by offering a cheap labor pool. Unless Vietnam can address the underlying causes of the middle income trap, specifically the shortage of skilled labor, it will be challenged to remain cost-effectively attractive to foreign investment. Without foreign investment, the country will have a hard time not only rising to the status of a modern industrialized nation; it will also have a hard time sustaining its present level of growth.

Vietnam must pursue a socio-economic strategy that increases the skills and training of its workers across the board, and the CPV is aware of the need to increase the skills of its labor force. In its *Socio-Economic Development Plan for the 2011-2015 Period*, the CPV cites the need to renovate and improve the quality of education and training and improve the quality of human resources in areas of leadership, management, governance and science and technology.⁷⁷ Additionally the plan also calls for increasing vocational training for 1 million rural laborers per year.⁷⁸ Finally, the government plans to increase investment in science and technology to develop research and transfer of knowledge as part of the production process in

⁷⁴ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report* , 12.

⁷⁵ Business Monitor International, *Vietnam Business Forecast Report: Recovery Losing Momentum*, 29.

⁷⁶ Political Risk Services, *Political Risk Yearbook: Vietnam Country Report* , 29.

⁷⁷ Government of Vietnam, "Socio-Economic Development Plan for the 2011-2015 Period."

⁷⁸ Ibid.

all sectors.⁷⁹ While Vietnam's plan addresses the 2011-2015 period and is the proper strategy for long term economic growth, it will likely be well beyond 2015 before tangible results are realized from these efforts due to the need to develop the requisite educational and technological infrastructure. To address the near to medium term, Vietnam should incentivize foreign companies to include training and technology transfer as part of an investment package into the Vietnamese economy. This transfer of technology would help the Vietnamese economy in two ways. First, it would increase the skill and training of the work force sooner rather than waiting for domestic development of these human resource improvements. Secondly, it would allow foreign businesses, using more skilled workers, to manufacture high-technology components and products domestically, which would increase the Vietnam's exports up the value chain.⁸⁰ If effective, encouraging knowledge transfer from foreign enterprises while domestically enhancing the education and vocational training of future workers will develop a higher quality and technologically advanced labor pool. This will ensure Vietnam remains attractive to FDI even with reasonable wage increases in the future while also allowing private domestic enterprises to be more competitive on a global scale; the results of both effects being a more sustainable long term economic growth.

COUNTER ARGUMENT

Some analysts have argued that compared to other Southeast Asian nations, Vietnam is too focused on attracting FDI instead of investing in education and technology required to move the quality of exports up the value chain.⁸¹ However, it is difficult to argue the success Socialist Vietnam has experienced in establishing an open economy that consistently remains attractive to outside investment. The effects of FDI contributed to dramatic increases in

⁷⁹ Ibid.

⁸⁰ Leung, *Economy (Vietnam)*, 14.

⁸¹ Business Monitor International, *Vietnam Business Forecast Report: Recovery Losing Momentum*, 23.

exports and substantially improved the socio-economic status of the population through real wage increases. A 2010 study using a more robust empirical methodology published in *ASEAN Economic Bulletin* confirmed “FDI inflow does exert an independent influence on Vietnamese Economic Growth.”⁸² Given the strong correlation between FDI and economic growth, as well as the strong performance indicators of exports and wage increases, one could certainly conclude that Vietnam should continue to pursue a strategy focused primarily on attracting FDI. However, while the 2010 study indicated FDI impacts economic growth, the study also concluded FDI does not generate a spillover affect to human capital from advance technology and knowledge transfer, and that economic growth results only from the addition of capital to the economy.⁸³ The simple addition of capital into the economy, while helpful, is not going to develop the quality of the labor force sufficiently to break through the middle-income trap in order to achieve long term economic growth in an increasingly competitive global market.

CONCLUSION

The overall goal for the implementation of the economic, financial and socio-economic strategies is to ensure long term growth through the development of private domestic enterprises as well as attracting foreign investment to Vietnam. To be successful, each of the individual strategies must achieve a particular end state. The end state of the economic strategy is for inefficient SOEs to have a reduced negative impact on the Vietnamese economy. This should be accomplished by resolving enterprise inefficient practices, increasing financial transparency and managerial oversight in SOEs and

⁸² Thu Thi Hoang, Paitoon Wiboonchutikul, and Bangorn Tubtimtong, Bangorn, "Does Foreign Direct Investment Promote Economic Growth in Vietnam?," 308.

⁸³ Ibid.

privatization of non-critical SOEs. The end state of the financial strategy is for all private domestic enterprises to have access to capital required to continue and ultimately expand business operations. The financial strategy must address providing equal access to all entities regardless of sector and ensuring adequate regulatory controls are enacted to make sufficient capital available support the market needs. Finally, the end state for the socio-economic strategy is a labor pool that possesses the requisite high technology skills that will remain attractive to foreign investment and support the needs of private enterprises to improve the value chain of domestically manufactured products. This strategy will accomplish this by investing in the domestic education and training of laborers while leveraging knowledge from foreign companies investing in Vietnam. The successful implantation of these strategies will greatly aid stable growth of the economy and will help Vietnam continue to reach its modernization goals.

While Vietnam's own strategies address most of the same areas of improvement, it is incumbent on the CPV to ensure the implementation and execution of these strategies is fully supported by the central government and, more importantly, at the local level. This will present an institutional challenge for the CPV seeking to maintain political stability. The interested outside observer should not only monitor key indicators to assess Vietnam's current economic health, but also examine progress towards the economic, financial and socio-economic end states mentioned above to ascertain the success of the country's full transition to an open market economy.

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